

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

WILLIAM and KIMBERLY WATSON,
Debtors.

Case No. 92-58372-MM
Chapter 7

KENNETH J. PETERSON,
Plaintiff,

Adversary No. 93-5140

vs.

MEMORANDUM DECISION

WILLIAM and KIMBERLY WATSON,
Defendants.

INTRODUCTION

Scheduled for hearing before the Court is Jackson National Life Insurance Company's Motion to Dismiss for Lack of Subject Matter Jurisdiction Over Subject Matter or, in the Alternative, for Abstention. For the following reasons, the motion should be granted with respect to only the state law, non-bankruptcy claims. The remaining claims for nondischargeability based on fraud and conversion should be severed and tried separately

FACTS

On December 7, 1992, the plaintiff, Kenneth Peterson, filed a complaint in Santa Clara Superior Court against the debtor, William Watson, and several other defendants, including the moving party, asserting causes of action for involuntary corporate dissolution, declaratory relief

1 regarding the ownership of shares of corporate stock, breach of contract, and intentional interference
2 with contractual relationship. The case is subject to the "fast track" system in the Superior Court.

3 The debtor filed a Chapter 7 bankruptcy petition on December 27, 1992. The plaintiff
4 commenced this adversary proceeding against the debtor and Jackson National Life Insurance
5 Company on March 12, 1993 asserting essentially the same claims (declaratory relief to determine the
6 ownership of shares of stock, breach of contract, and fraudulent interference with contract). In
7 addition, the adversary complaint asserts claims for non-dischargeability based on fraud and
8 conversion. The plaintiff has demanded a jury trial.

9 Jackson National moves for dismissal of the adversary proceeding under Federal Rule 12(b),
10 or, in the alternative, for either mandatory or discretionary abstention under 28 U.S.C. § 1334(c). It
11 asserts that the case is non-core and does not consent to the entry of final judgment by the
12 Bankruptcy Court. It further asserts that it is entitled to a jury trial.

13 DISCUSSION

14 A. Mandatory Abstention

15 28 U.S.C. § 1334(c)(2) provides that abstention is mandatory if three elements are satisfied:

16 (1) The proceeding is based upon a state law claim or cause of action which, although related
17 to a case under Title 11, does not arise under Title 11 or arise in a case under Title 11;

18 (2) The proceeding could not have been commenced in federal court absent bankruptcy
19 court jurisdiction; and

20 (3) The proceeding could be timely adjudicated in a state court. 28 U.S.C. § 1334(c)(2).

21 The first element required for the mandatory abstention statute to apply is that the proceeding
22 must not arise under Title 11 although it may be a related proceeding. In re McFadyen, 145 B.R.
23 657, ___ (Bankr. E.D. Cal. 1992). A civil proceeding is "related to" bankruptcy if the outcome of the
24 proceeding could conceivably have any effect on the estate being administered in bankruptcy. In re
25 Feitz, 852 F.2d 455, 457 (9th Cir. 1988). Accord In re Pacor, 743 F.2d 984, 994 (3d Cir. 1984).

26 28 U.S.C. § 157(b)(2) enumerates a non-exclusive list of specific matters that are deemed
27 core. It includes several broad, catch-all provisions under subsections (A), (E), and (O). 28 U.S.C. §
28 157(b) was adopted in 1984 to address some of the constitutional concerns raised in Northern

1 Pipeline Constr. v. Marathon Pipe Line Co., 458 U.S. 50, 102 S. Ct. 2858 (1982). "Although this list
2 appears to cast an extremely wide net, caselaw in light of Northern Pipeline . . . has developed a more
3 precise definition." McFadyen, 145 B.R. at ____.

4 The plaintiff's claims against Jackson National arise under state contract, tort, and
5 corporations law. However, a determination whether a proceeding is or is not core is not based
6 solely on its resolution by state law. 28 U.S.C. § 157(b)(3). To determine whether a case is core,
7 the Court must look to both the form and the substance of the proceeding. In re Wood, 825 F.2d 90,
8 97 (5th Cir. 1987)(wrongful appropriation of corporate assets is non-core). To be considered core, a
9 proceeding must involve a right created by federal bankruptcy law or that would arise only in
10 bankruptcy. Id. at 96-97. A proceeding that does not invoke a substantive right created by federal
11 bankruptcy law, that could exist independently outside of bankruptcy, and that could proceed in
12 another court in the absence of bankruptcy is not a core proceeding. Id.

13 None of the specifically enumerated matters set forth in 28 U.S.C. § 157(b)(2) are applicable
14 to this proceeding except for subsection (I) relating to the dischargeability of particular debts and two
15 of the catch-all provisions: 1) subsection (A) relating to "matters concerning the administration of the
16 estate;" and 2) subsection (O) relating to "other proceedings affecting the liquidation of the assets of
17 the estate or the adjustment of the debtor-creditor or the equity security holder relationship."
18 However, subsections (A) and (O) are applicable only if they are literally read.

19 The Second Circuit has indicated that the language of subsection (A) could be construed to
20 include almost any matter relating to bankruptcy, but that the structure of the statute as a whole does
21 not permit such a construction. In re Ben Cooper, Inc., 896 F.2d 1394, 1398 (2d Cir. 1990),
22 vacated, 111 S.Ct. 425 (1990), reinstated, 924 F.2d 36 (2d Cir. 1991). The Fifth Circuit has also
23 noted that the language of subsection (O) is similar in scope to the test for jurisdiction in 28 U.S.C. §
24 1334 and has declined to give subsection (O) a broad reading. To do so would include the entire
25 range of bankruptcy proceedings within the scope of core proceedings, contrary to the constitutional
26 limitations articulated in Marathon. In re Wood, 825 F.2d at 95.

27 In In re Castlerock Properties, the Ninth Circuit addressed the issue of the determination of
28 core matters. It held that state law contract claims that do not fall within the categories of core

1 proceedings enumerated in 28 U.S.C. § 157(b)(2)(B)-(N) are related proceedings under § 157(c)
2 even if they arguably fit within the literal wording of the two catch-all provisions, sections
3 157(b)(2)(A) and (O). In re Castlerock Properties, 781 F.2d 159, 162 (9th Cir. 1986). To hold
4 otherwise would permit bankruptcy courts to enter final judgments that the Supreme Court has held
5 to be unconstitutional. The Ninth Circuit emphasized that courts "should avoid characterizing a
6 proceeding as 'core' if to do so would raise constitutional problems." Id.

7 The Ninth Circuit reiterated that position in In re Cinematronics, Inc., a case which involved
8 state law claims against a non-debtor shareholder for breach of contract, breach of the covenant of
9 good faith and fair dealing, and fraud. In re Cinematronics, Inc., 916 F.2d 1444 (9th Cir. 1990). The
10 Court indicated it could find "no clear expression of congressional intent to include within the catch-
11 all categories of core proceedings state claims that relate to a bankruptcy proceeding but that exist
12 against a non-debtor." Id. at 1450.

13 It should be noted that some courts have held that the enforcement of a postpetition contract
14 is a core matter because postpetition contracts are integral to the administration of the estate from the
15 day that the contracts are executed. In re Ben Cooper, 896 F.2d at 1399; In re Case, 937 F.2d 1014,
16 1020 (5th Cir. 1991). However, except for the claim for non-dischargeability, the plaintiff alleges the
17 prepetition breach of a prepetition contract and asserts other prepetition claims. The claims asserted
18 are independent of and preceded the bankruptcy petition. Although the determination of those claims
19 will ultimately affect the administration of the estate, those claims became part of the assets of the
20 estate under § 541 upon the filing of the bankruptcy petition. This proceeding is, therefore, a related,
21 non-core proceeding.

22 There have been no other bases for federal jurisdiction asserted, and the Court is aware of
23 none.

24 Jackson National has submitted evidence that this case is subject to the "fast track" system
25 and is likely to be processed expeditiously in the Santa Clara County Superior Court. Therefore,
26 there is no reason to believe that this case would not be timely adjudicated if this Court abstains.

27 As all three elements for mandatory abstention are satisfied, this Court abstains from hearing
28 the state law claims this case. After the state court claims have been adjudicated, the plaintiff may

1 proceed against the debtor on its claims for non-dischargeability in this Court. This Court would then
2 give collateral estoppel effect to those elements of the claims that are identical to the elements
3 required for discharge and which were actually litigated and determined in the Superior Court action.
4 Grogan v. Garner, ___ U.S. ___, ___, 111 S. Ct. 654, 658 (1991).

5 **B. Discretionary Abstention**

6 The Court may, in its discretion, abstain from hearing a matter in the interest of comity with
7 state courts or respect for state law. 28 U.S.C. § 1334(c)(1). Even if the Court were to deny
8 Jackson National's motion for mandatory abstention, discretionary abstention would be appropriate
9 because the factors enunciated in Tucson Estates, Inc. tip in favor of abstention. In re Tucson
10 Estates, Inc., 912 F.2d 1162, 1167 (9th Cir. 1990); In re Eastport Associates, 935 F.2d 1071, 1075
11 (9th Cir. 1991). The factors that are significant to the Court's determination that discretionary
12 abstention would be appropriate include that: most of the claims are related, non-core claims; state
13 law issues predominate; a related proceeding is currently pending in State Superior Court; there is no
14 other basis for federal jurisdiction over the claims other than the dischargeability claims; the state law
15 claims are severable from the dischargeability claims; the Superior Court was the plaintiff's original
16 choice of forum; the parties have a right to a jury trial; non-debtor parties are present in the
17 proceedings; and the case is likely to be tried in Superior Court as quickly as it would be tried in the
18 bankruptcy court.

19 **CONCLUSION**

20 Jackson National's motion for abstention is granted with respect to all claims arising under
21 state law, but the Court reserves for later determination the issue of the dischargeability of the debts
22 arising from the debtor's liability on those claims.
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